



Republika e Kosovës
Republika Kosova - Republic of Kosovo

ZYRA E RREGULLATORIT PËR ENERGJI
REGULATORNI URED ZA ENERGIJU
ENERGY REGULATORY OFFICE



Consultation Paper

Annual Adjustments of Maximum Allowed Revenues for KEDS

(April 2019 - March 2020)

DISCLAIMER

This Consultation Paper has been prepared by ERO for the purpose of informing stakeholders. It does not represent a decision by the ERO and should not be interpreted as such.

March 2019



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1 Introduction

The Energy Regulatory Office (ERO) is currently carrying out the Regular Adjustment and the Annual Update Process for Maximum Allowed Revenues (MAR) that will be recovered by the Regulated Companies. Under this process, ERO will approve the updated MAR for the Transmission System Operator and Market Operator (KOSTT, TSO/MO), Distribution System Operator (DSO, KEDS) and Universal Service Supplier (USS), based on the proposals submitted by the regulated companies as well as decisions on Maximum Allowed Revenues for the regulatory period 2018-2022. These evaluations will then be used by the Regulated Companies to propose their tariffs for this year, which shall be effective starting from 1 April 2019.

The Price Regulation is a tool used by ERO in order to set the Maximum Allowed Revenues- MAR, which the Regulated Companies shall collect for provision of regulated services. MAR is set at the level that enables the regulated licensee to cover the justifiable operational and maintenance costs of their assets and realize a justifiable return of their investments. Also, ERO sets the efficiency targets, which aim the increase of the operational efficiency of companies and provide incentives for fulfilling the targets, or penalties in case the companies fail to fulfill them.

The basic values for MAR components are set at the Periodic Review, carried out in 2018 and remain valid for a five-year period. The current review is related to the evaluations for MAR, presented by the Regulated Companies and their adjustment with basic values for relevant tariff year 2019. This review evaluates whether the proposals of the licensees are calculated in line with legal requirements.

ERO invites the regulated companies, customers and other stakeholders to provide their contribution in this process by reviewing and commenting on the data and views presented in this Consultation Paper, in order to have an accurate evaluation of Maximum Allowed Revenues for Distribution System Operator.

The parties who want to present their eventual comments on ERO's proposals are invited to submit their written comments via electronic mail at ero.pricing-tariffs@ero-ks.org, by 8 March 2019 at the latest. The comments can also be submitted via post at:

Zyra e Rregullatorit për Energji
Departamenti për Tarifa dhe Çmime
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Relevant Documents

Final Evaluation of DSO MAR, within the Periodic Review Process- Detailed Evaluation	http://ero-ks.org/2018/Raportet/Pergjigje%20ndaj%20komenteve%20te%20KEDS_PRR2_final.pdf
KEDS Application for 2019	http://www.ero-ks.org/2019/Tarifat/Aplikimi_i_OSSH_per_MAR_viti_2019.pdf



2 Adjustment of Maximum Allowed Revenues

ERO, based on the Rule on DSO Maximum Allowed Revenues, received the applications and carefully analyzed all cost components and requirements of the licensee. During the Regular Adjustment Process, ERO used the results taken during the Periodic Review Process 2018-2022 and adjusts the MAR to reflect the difference between the costs that have been forecast during the Periodic Review and actual costs, incurred by Regulated Companies, due to reasons out of their control. During this process, ERO will:

1. Index the Operational and Maintenance Costs for the Efficiency Factor, which is set during the Periodic Review Process and for the Annual Inflation, which is set by using the Harmonized Index of Consumer Prices (HICP) for the countries of the Eurozone;
2. Set the Allowed Cost of Losses (LSSCt) for the DSO and update these to include the difference between allowed and actual cost of losses for the previous Regulatory Period, which may have arisen due to changes in wholesale power costs or changes in the flows of electricity in the distribution system;
3. Update DSO MAR in order to reflect the difference between the Allowed Revenues and Actual in the relevant previous year (t-1), including the excluded revenues;
4. Set DSO MAR for Relevant Year t.

3 Electricity Balance

ERO has used the balance updated by KEDS to take into account the updated consumption and evaluation for deregulation of customers connected to the voltage level 35kV. The implementation of legal changes within the framework of the market liberalization has an essential impact in handling the losses in electricity system. The updated Balance will be used to calculate the wholesale energy purchases for covering the transmission and distribution losses and the retail tariff for Universal Service.

3.1 Evaluation of Actual and Forecast Electricity Balance

With the purpose of evaluating the costs related to purchase of losses at DSO level, ERO has analyzed the data reported by KEDS for 2018 and the data for the forecast of Balance for 2019. The analysis of the actual balance for 2018 and the balance forecast for 2019 is presented in the following table:

Table 1: Electricity Balance

Electricity Balance at DSO	Unit	Realization 2018	Proposal 2019
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Entry at DSO	GWh	5,120	5,048
Unbilled Energy in the North	GWh	272	259
Entry at DSO without the unbilled energy	GWh	4,848	4,789
Entry at DSO without the unbilled energy	%	5.3%	5.1%
Technical and Commercial Losses at DSO	GWh	1,157	949
	%	22.6%	18.8%
Total Losses	GWh	1,429	1,208
	%	27.9%	24.1%
Energy remained for billing	GWh	3,691	3,840
Billing from KEDS	GWh	3,640	3,840
Return of Losses	GWh	51	-

During the recent years, following the changes in the tariff structure, there has been an increase of electricity consumption. This increase of consumption comes as a result of removal of tariff blocks and seasonal differences. Therefore, in 2017, there was an increase of consumption for 6.4% compared to 2016, whereas in 2018 there is an increase of consumption for 4.5% compared to 2017. The forecast of consumption for 2019 shows that the increase will continue further. However, if the level of losses is realized as allowed by ERO, then it is expected that the gross consumption will remain in approximate levels as in 2018. The target of distribution losses, allowed by ERO for 2019, is 18.8%.

In its application, KEDS required that only 20% of costs resulting from billing of energy for return of losses shall be taken into account, due to the impossibility of their collection, as a result of delays in court proceedings. The return of losses, according to KEDS report and ERO's verifications, results in an amount of 51 GWh electricity. Such value is used during the calculation of revenues realized from sales.

ERO considers that the cost that results from billing of such energy shall be treated as a total revenue, because this is treated with the accrual principle, where the revenues are recognized at the moment of billing, not when they are collected. Furthermore, it shall be emphasized that this amount of energy of 51 GWh is included in the energy entering the distribution system. From this basis, the costs of energy losses are calculated, therefore the recognition of this energy as a cost, means also the recognition of costs resulting from this energy.

From the table above, it is noticed that the losses in the north are presented as physical flows and are used for the purpose of reconciliation of the electricity balance. However, costs that are derived from the supply of four northern municipalities of Kosovo are not included during the calculation of energy supply costs. Currently this energy is being provided by the interconnection system withdrawals and this energy is accumulating as KOSTT's debt to ENTSO-E.



4 Regular Adjustments

This part presents the calculations related to regular annual adjustments for 2018. The calculation of these adjustments will be included during the determination of Maximum Allowed Revenues for relevant tariff year 2019.

4.1 Adjustments for Inflation Rate

In order to carry out the calculation of adjustments related to the inflation rate, as a reference was taken the inflation rate published by Eurostat for Eurozone countries, which for 2018 was 1.73%¹. The manner for calculation of such adjustments is set in the Rule on DSO Revenues.

This rate is applied in adjustment of operational costs, depreciation costs and return on capital. Following the application of the inflation rate of 1.73% towards the above-mentioned cost components, the value of adjusted costs in an amount of 0.87 million Euros is derived. The adjustments that have resulted from the application of inflation rate for each of the components of allowed costs in 2018, have been added to the preliminary evaluation of the costs evaluated for 2019. The details on these calculations are presented in the following table:

Table 2: Adjustments for inflation

Line	Unit	a) Allowed 2018	b) Adjustment for HICP	c) Preliminary Evaluation 2019 ²	d=b+c Allowance 2019
OPEX	mil€	26.18	0.45	25.85	26.30
Depreciation	mil€	12.23	0.21	14.44	14.65
Return	mil€	11.72	0.20	13.39	13.59
Total	mil€	50.13	0.87	53.68	54.54

4.2 Adjustment of Pass-Through Costs

Due to differences between the actual and forecast energy from DSO, related to DSO obligations towards Market Operator (MO) and System Operator (SO), the adjustments to reflect these differences were carried out. The value of these adjustments is -0.27 million Euros.

4.3 Adjustments of the Costs of Losses

Adjustment of the cost of losses for DSO is carried out through the following formula:

¹https://www.ecb.europa.eu/stats/ecb_statistics/escb/html/table.en.html?id=JDF_ICP_COICOP_ANR&period=2017-12

² According to allowances of Periodic Review 2018-2022 link:

http://ero-ks.org/2018/Raportet/Pergjigje%20ndaj%20komenteve%20te%20KEDS_PRR2_final.pdf



$$(LSSCat-1 - LSSCft-1) * (1 + I_t)$$

The value of the adjusted cost for losses is 8.68 million euros, which results due to higher energy flows, realized towards the forecast ones and the average higher price for purchase of losses for 2018 in the distribution system. The details on the calculations are provided in the following table.

Table 3: Adjustments for the Cost of Losses

DSO MAR	Unit	Allowed 2018	Actual 2018	Proposed 2019
Indexation Parameter				
I_t	%		7.49%	
Allowed Losses (LSSCt)				
LSSA _t	%	18.8	18.8	18.8
REUE _t	GWh	4,539.5	5,120.1	5,048.3
WHEA _t	€/MWh	44.00	47.40	42.97
LSSCa _{t-1}	mil€		45.63	
LSSCf _{t-1}	mil€	37.55		40.78
Adjusted Costs³	mil€		8.68	

Where:

$LSSA_t$ is the Loss Allowance, which is a percentage of energy entering the Distribution System, in Relevant Year t

$REUE_t$ is the energy units (in MWh) or (GWh) entering the Distribution System in Relevant Year t

$WHEA_t$ is the average wholesale energy cost (in €/MWh) as in Relevant Year t

$LSSCa_{t-1}$ is the actual allowed cost of losses in Relevant Year $t-1$ (calculated using the Loss Allowance)

$LSSCf_{t-1}$ is the forecast cost of losses in Relevant Year $t-1$ (calculated using the Loss Allowance)

I_t is the interest rate for the Relevant Year t calculated based on EURIBOR plus $S\%$, where S is a value to be determined by the Regulator at Periodic Reviews and which reflects the premium payable by the licensee for short-term loans above the EURIBOR rate

The forecast of the average price for losses in 2019 was carried out through the indexing of the actual generation price from KEK for the harmonized inflation rate of 1.73% and the forecast of import price, based on the actual realized prices as well as referent prices in regional stock markets.

³ These costs are part of general updates and are reflected in 2019 MAR.



4.4 Adjustments of Non-Tariff Revenues

Other revenues realized from unregulated activities, such as: the revenues from lease of assets, the revenues from different economic operators, the sale of assets, different services towards customers etc, are deducted from the Maximum Allowed Revenues. The value of these revenues realized from DSO in 2018 is reported by KEDS in an amount of 6.6 million Euros, however, ERO has taken the realized value of revenues from excluded services from draft- Financial Statements, submitted to ERO, which are in an amount of 10 million Euros. The main difference is that KEDS has not presented the revenues realized from energy imbalances.

In relation to the handling of energy imbalances, ERO has also explained in the previous review that these revenues have resulted from the nominations and not system balance. The balancing of the system is a responsibility of KOSTT, and for this purpose, ERO has allowed the balancing costs. The management, namely the balancing of the system, is carried out in the principle of the demand and offer and in order to provide this function, the balancing mechanism was established within TSO/MO. Whenever there is a difference in the system between the demand and the offer, TSO activates this mechanism with the purpose of balancing the system. This is carried out through activation of ancillary services or through DMS.

From what was stated above, the revenues realized by KEDS from “energy imbalances” do not represent the costs related to the balancing of the system, but they have resulted from nomination aspects. As a basis for handling these revenues as non-tariff revenues, is that these revenues are realized out of the tariffs for use of distribution system, and from their application the regulated revenues should be realized. Any revenues out of this framework are handled as non-tariff revenues. The way they are handled is foreseen in the Rule on DSO Revenues:

$$MAR_t = OPM Ct + DEPCt + RTN Ct + LSS Ct + LIC Ct - NTFR t + ADJt + KREVt$$

As seen from the formula above, the non-tariff revenues are handled as revenues deducted during the determination of Maximum Allowed Revenues. The correction of these costs/revenues can be carried out through the revenues correction factor $KREV_t$.

With respect to concerns raised in the application of KEDS, related to imbalances of 2017, ERO expects from KEDS, within this consultation process, to provide the data related to energy, average price and the cost realized in 2017 from DSO for covering the losses for the entire period (January-December 2017).

It should be emphasized that the costs or the revenues that result from balancing mechanism shall be handled within the framework of other non-tariff revenues. This issue will continue to be handled in this manner, by carrying the costs or the compensations to customers on these criteria of the market and the current regulatory framework.

4.5 Adjustments of Revenues Correction Factor

The correction of revenues for 2018 was carried out in line with Rule on Maximum Allowed Revenues. The Principle which is applied is related to the general evaluation of allowed actual costs and actual realized revenues. These calculations were carried out according to the following formula:



$$KREV_t = (AAC_{at-1} - ARR_{t-1}) * (1 + I_t)$$

Where:

AAC_{at-1} Actual Allowed Cost as determined in Relevant Year t-1

ARR_{t-1} is the Actual Regulated Revenues in Relevant Year t-1

I_t is the interest rate for the Relevant Year t calculated based on EURIBOR plus S%, where S is a value to be determined by the Regulator at Periodic Reviews and which reflects the premium payable by the licensee for short-term loans above the EURIBOR rate

The difference between AAC_{at-1} in an amount of 84.8 mil€ and ARR_{t-1} in an amount of 80.2 mil€, following the application of interest rate, results in an amount of 4.98 mil€. The difference between actual allowed costs and revenues is passed-through as an adjustment during the determination of MAR for 2019.



5 Proposal for DSO Maximum Allowed Revenues

DSO Maximum Allowed Revenues are calculated according to the following formula:

$$MAR_t = OPMC_t + DEPC_t + RTNC_t + LSSC_t + LICC_t - NTFR_t + ADJ_t + KREV_t$$

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MAR_t Maximum Allowed revenues in relevant year t

$OPMC_t$ allowed operational and maintenance costs in relevant year t

$DEPC_t$ allowed depreciation in relevant year t

$RTNC_t$ allowed return on capital in relevant year t

$LSSC_t$ allowed cost of losses in relevant year t

$LICC_t$ license tax in relevant year t

ADJ_t adjustment of costs

$KREV_t$ revenue correction factor in relevant year t

The calculation of each of these components is elaborated below.

Table 1 Proposal of DSO MAR (KEDS) after the adjustments

DSO MAR		2018 Allowed	2018 Actual	2019 Evaluated (PRR2)	2019 Proposed
Indexation Parameters					
Efficiency Factor	%			1.5%	
HICP	%		1.73%		
Euribor	%		-0.11%		
S-factor	%		7.6%		
It	%		7.49%		
Operational and Maintenance Costs (OPMCt)					
$OPMC_t = OPMC_{t-1} * (1 + CPI_{t-1}) * (1 - E_t) * (1 - P_t)$	€m	26.18	26.18	25.85	26.30
License Cost			0.09		
Excluded Costs				-0.41	
Allowed Depreciation (DEPCt)					
$DEPC_t = DEPC_{t-1} * (1 + CPI_{t-1}) * (1 - P_t)$	€m	12.23	12.23	14.44	14.65
Allowed Return (RTNCt)					
$RTNC_t = RTNC_{t-1} * (1 + CPI_{t-1}) * (1 - P_t)$	€m	11.72	11.72	13.39	13.59
Obligations for SO and MO					
Obligations for SO and TO	€m	0.79	0.54	-	1.13
Allowed Losses (LSSCt)					
LSSAt	%	18.80	18.80	18.80	18.80
REUet	GWh	4,539.1	5,120.1	4,641.7	5,048.3



WHEAt	€/MWh	44.00	47.40	40	42.97
LSSCat-1			45.63		
LSSCft-1	€m	37.55		34.91	40.78
LSAct-1					
LSSCt					
Adjustments					
Unregulated revenues	€m	-3.50	-10.05	-3.50	-3.50
Adjustments of PRR1 and 2017					
Adjustments	€m	-1.50	-1.50	-1.50	-1.50
DSO MAR					
Preliminary MAR	€m	83.46	84.82	83.18	
KREV					
AAC _{t-1}	€m		84.82		
ARR _{t-1}	€m		80.19		
KREV_t = (AAC_{t-1} – ARR_{t-1}) * (1+ It)	€m		4.98		
KREV_{t-1}	€m				4.98
Final MAR	€m				96.44

As a result of calculations of each cost component, the proposed MAR for DSO for 2019 is €96.44 million.